

## Economic uncertainty and the European trade landscape

In 2022, ongoing geopolitical conflict, persistent high inflation, rising interest rates, record-breaking energy prices, and labor shortages created a challenging business and risk environment. The economic outlook for 2023 is proving difficult to read, and recent competing trade policies from the United States and Europe have added new complexities for directors and companies to consider.<sup>1</sup>

On 21 March 2023, members of the European Audit Committee Leadership Network (EACLN) met with Andrew Kenningham, chief Europe economist at Capital Economics, to discuss the economic outlook and with Jacob Kirkegaard, senior fellow at German Marshall Fund, to explore the global trade landscape.

This *ViewPoints* covers observations that emerged during the meeting and premeeting conversations:<sup>2</sup>

- **The overall economic outlook is more positive than anticipated, but uncertainty remains**
- **The trade landscape is complex and evolving under geoeconomic pressures**
- **Globalization is being reshaped and international solidarity tested**

For a list of meeting participants, see [Appendix 1 \(page 8\)](#); for a list of reflection questions for audit committees, see [Appendix 2 \(page 9\)](#); for guest biographies, see [Appendix 3 \(page 10\)](#).

### The overall economic outlook is more positive than anticipated, but uncertainty remains

Boards have an important role to play in working with management to ensure that rigorous stress-testing and resiliency plans are in place during challenging economic times. EACLN members reported that this is particularly difficult because the current economic environment is so complex. One said, *“The real question is: Are there any parallels to prior events?”* Members noted that macroeconomic forces are both interconnected and compounding, with data that supports contradictory narratives.

A difficult winter with potential energy shortages and a recession were widely forecasted for the end of 2022, but unseasonably warm weather, government stimulus spending, and an agile business response helped keep Europe’s economy afloat. *“It was thought that the Eurozone would suffer a huge recession in Q4 ‘22 and Q1 ‘23 because of the scale of the energy price shocks—which were comparable to the additional costs of oil in 1974 and 1979, and in the ‘70s, it resulted in a recession. However, things worked out better than feared; it was almost a ‘good’ experience over winter,”* Mr. Kenningham noted. *“What surprised people*

*was both the scale of government support throughout Europe and that the private sector reduced energy consumption quite effectively.” Members agreed that there is a new normal for companies in responding quickly to global crises. One said, “I think we have a certain resilience; we’ve learned to adjust and adapt in a faster way than people expected.”*

Nevertheless, questions remain and most anticipate an impending economic contraction. When polled during the meeting, most EACLN members said they expect a mild downturn in 2023. Mr. Kenningham agreed: *“With rising interest rates related to the energy shock, we think growth will slow and cause the economy to contract slightly, with small contractions in Q2 and Q3. The shocks over the last few years—for example, the pandemic and energy supply—the legacies from these aren’t yet clear.”* Members also worried about the uncertainties of interconnected macroeconomic forces and raised the following questions:

- **What will happen to interest rates, particularly in light of recent bank failures?** Members noted the *“dilemma”* central banks face on whether to raise interest rates to fight inflation. Mr. Kenningham explained, *“The European Central Bank is trying to distinguish between financial system stability and giving themselves room to operate on interest rates. If banks’ problems get really big, they will have to cut interest rates; it’s a risk.”* He thinks the European Central Bank is *“giving themselves flexibility to wait and see what the data shows,”* but that the end of rate hikes is unlikely: *“Inflationary pressure is still very high. Over the next year or two, inflation won’t come down smoothly to the 2% target as quickly as the European Central Bank is forecasting, as wage pressure is going to be consistent.”*
- **What will happen to energy prices?** Audit chairs expressed concerns over energy prices, with one saying, *“Energy is a big uncertainty, and it has a couple of angles—for example, ESG reporting. It’s both the energy prices that we all pay, but also how much we use, how much our equipment and factories use, and can we reduce it more.”* Another highlighted the challenges with floating-rate energy contracts. However, both guests suggested that energy prices may continue to fall. *“We’re now more optimistic about the energy outlook,”* said Mr. Kenningham. Mr. Kirkegaard agreed: *“Gas is not materially higher than real prices prepandemic when it was in the mid-30s in real euros. Yes, it’s an increase of 20%–30%, but it’s not anywhere near the prices of last year.”*
- **What will the labor market look like?** Labor shortages are top of mind for many EACLN members. One noted, *“I’m really concerned about the supply of labor. It seems like people’s attitude toward work changed during and after the pandemic.”* Another member concurred: *“We see high pressure on the labor market; it’s difficult to find employees in many businesses, especially in roles with specific skills.”* Mr. Kenningham agreed: *“The labor market is much tighter than anyone anticipated given the economic activity levels. In some countries, this seems to be a partial legacy of pandemic-related government benefits.”* Members shared observations on current workforce challenges:
  - **Attitudes toward work have evolved since the pandemic.** Members discussed the clash between traditional office-based, 40-hour workweek cultures and attitudes since the pandemic. *“We’re in a period of transition where companies are trying to recruit people into the old ways of working,”* said one. *“But I think younger people are ahead of*

*us—they realize it doesn't work and want to be a part of a new way of working. We're trying to recruit into professions that maybe shouldn't exist how they exist today."*

- **Increasing anti-immigration sentiment is impacting labor.** Members discussed how anti-immigration ideologies exacerbate labor shortages, with one member saying, *"Immigration today is seen as the worst thing."* But members don't see governments intervening. One said, *"The government isn't touching this. It's not only an issue for our companies—it's much bigger."*
- **However, immigration offers no simple solution to the shortage.** One member said, *"I wonder if large European corporations can do more in terms of creating programs to attract immigration in the right ways for roles where the numbers haven't been that large over the last few years. When was the last time your companies put a program in place for certain geographies and skills? I don't see it enough."* Another noted the complexities with immigration policy: *"I don't know if immigration is the solution. I doubt it. If you want it as a solution, you need to select the people you want and say no to others, and that's another political issue not being solved."*

## The trade landscape is complex and evolving under gloeconomic pressures

The outlook for trade is unusually difficult to decipher, according to EACLN members. The lingering effects of the pandemic, supply chains disrupted by the war in Ukraine, and resurgent Chinese aggressiveness all complicate the picture. And US policymakers are pursuing multiple objectives, some of which conflict with one another and create challenges for European companies: fighting climate change, for example, but also making the United States more secure in access to critical goods, building regional and global alliances, and curbing China's economic influence.

The European landscape is equally challenging to read, and with the implementation of national subsidies in the effort to combat climate change, companies now face tough choices, according to an EACLN member: *"If you want to build a new factory and you're choosing between the US and Europe, you can get a subsidy from the US government, so you prefer to build it in the US. Maybe it's targeted at China, but it's hitting Europe."*

Members addressed two significant additions to the trade policy landscape—the US Inflation Reduction Act (IRA) and Europe's Carbon Border Adjustment Mechanism (CBAM)—discussing the strengths and weaknesses of each policy, the US carrot versus the European stick:

- **The IRA uses tax credits to incentivize green investments.** The IRA was enacted in August 2022. At \$369 billion, it is the United States' largest investment in clean energy solutions to date, primarily focused on rewarding investment in green energy, products, and services, including \$270 billion in estimated tax incentives. Its further goal of increasing domestic industrial productivity has sparked global concerns. Mr. Kirkegaard said, *"In my opinion, the IRA is going to be a massive stimulus for investment in the US that could reach \$1 trillion over more than a decade; it will be 'market developing,' if you like. It offers very big*

*business opportunities for European firms to locate production in the US, which is obviously the intent of the bill.”*

- **CBAM uses a levy to discourage carbon-intensive processes.** Proposed by the European Commission and due to begin its initial phase in October 2023, CBAM aims at achieving climate neutrality by 2050. It requires European Union (EU) importers to purchase certificates equivalent to the amount of emissions generated in the production of the goods.
- **Both policies will accelerate the green energy movement.** Although the IRA and CBAM drive economic competition, members and guests agreed that they will contribute to increased production and use of renewable energy. *“I believe the ‘fit for 55’ goal of having 40% of energy from renewable sources in the overall energy mix by 2030 will easily be met in Europe because of the incentive to build new solar and wind in Europe,”* Mr. Kirkegaard said. *“It will be a direct function of fossil-fuel electricity having to pay the carbon price. Europe is using prices, and it will be effective. Energy-intensive industries in Europe are pushing the stimulation of green transition.”*
- **Both policies will affect trade flows and diplomatic relations.** The IRA, particularly, has raised concerns within Europe, with some viewing it and subsequent rulings as a signal of US protectionist tendencies. As one audit chair put it, *“The IRA is more like the ‘importation’ reduction act.”* Another added, *“When you look at the preconditions to do research and development, the situation is better in the US compared to Europe.”* Members and guests identified additional potential issues for multinational relations:
  - **CBAM is already outdated and could cause retaliation.** *“The problem is when you mapped out who’d be most affected by the original CBAM proposal that came out in 2021, it was Russia, Ukraine, Turkey, and China. They account for two-thirds of the total trade impact of CBAM,”* Mr. Kirkegaard said, which *“creates risk of retaliation.”* In his view, CBAM has the potential to be more successful than the IRA, but it needs updating: *“I’d argue Europe’s approach is a more effective policy than the US’, but the CBAM proposed in 2021 is already outdated due to the war in Ukraine and sanctions on Russia. This means they will have to think of a very different design, as the EU carbon price is around €90/ton and EU businesses want a level playing field.”*
  - **The IRA goes against World Trade Organization (WTO) rules.** *“Looking at the IRA, ‘friendly’ isn’t the first word that comes to mind,”* one member said. *“The focus is purely relocation. I understand why, but it’s not compliant with the WTO’s rules. Does it mean those rules don’t matter anymore?”* Mr. Kirkegaard explained that the IRA challenges the WTO’s enforcement ability and weakens its legitimacy: *“The Biden administration has continued the amputation of the WTO. He resisted appointment of new judges to the appeals court. This means that when countries complain to the WTO over these explicitly protectionist measures in the IRA, the WTO no longer has a functioning dispute-settlement mechanism. It has no enforcement mechanism anymore, no way to discipline countries who want to break the rules for domestic political reasons.”*

- **The IRA will exacerbate relations with China.** In Mr. Kirkegaard's view, the wider geopolitical impact of the IRA *"cannot be underestimated."* He explained, *"There might be ways the US and Europe can agree to mitigate some effects of the IRA, but I'm confident that the political price to the EU will be to more explicitly confront China."*

## Globalization is being reshaped and international solidarity tested

Geopolitical tensions remain a focus for EACLN members. As one put it, *"You have to follow what's happening in Russia and China, and you have to try to figure out what it means for your business. There are very many uncertainties."* Members have many questions about the future of globalization and threats to political and economic solidarity. Mr. Kenningham described how US-China polarization is reshaping but not ending globalization: *"Apart from extreme geopolitical scenarios, it's not likely that this will affect most streams of business. It will have a very big impact on a minority of industries, clearly the tech sector. It will be a rewriting of globalization rather than a rolling back of globalization—for example, the iPhone being constructed in India rather than China."*

Members and guests described other developments:

- **The Russia-Ukraine war is forcing decisions around international alignment.** In a discussion on the war in Ukraine, one member said, *"It's not in your hands; you have to have your scenarios, look into the resilience of your organization, look at agility with risk cartographies and stress tests. It's something I think is really important."* Mr. Kirkegaard observed, *"The fact that the Japanese prime minister went to Kyiv and is meeting Zelenskyy the day Chinese president Xi's in Russia meeting Putin is a stronger signal of where we're going than the continued close political relationship between Russia and China. It very clearly signals to me that Japan is realigning itself to the world of trading blocs."*
- **The war is creating diplomatic tensions between the West and developing countries.** *"We have to realize that only 40 countries are supporting the sanctions on Russia; the rest aren't. The Western view of democracy versus totalitarianism isn't shared by everyone, and developing countries view the war as primarily a regional conflict. The gap between the West and the developing world, especially Africa, is going to widen,"* a member said. *"This is something we have to be aware of. Russia and China are very present in Africa. When we look at geopolitical instability, we also have to look at Africa."*
- **Economic cohesion within Europe is weakening.** Although the war in Ukraine may have improved pan-European military resolve, national economies may be diverging. In his November meeting with Xi Jinping, German Chancellor Olaf Scholz announced that *"we do not believe in ideas of decoupling"* with China.<sup>3</sup> A member observed, *"This was very different from what France was intending to do. The two countries, for logical reasons, are not sharing the same strategy."* Diminished solidarity within the union will have serious consequences for EU national economies, he continued: *"If I want to be cynical, the other*



*parts of the world— especially China and the US—will be in a good position to take advantage of the divergence of EU countries.”*

- **China’s slowing economy will impact global trade.** Reduced growth in China will have repercussions across the world. Members discussed several:
  - **European export growth may be at risk.** A member said, *“Dependency on China as a market for certain European countries’ exports has become so big. Considering potential geopolitical crises and tensions in Taiwan, the risk of losing that market is quite large for some companies, much larger than the Russian exit has been.”* In Mr. Kirkegaard’s view, China’s economy will not bounce back to historic growth levels. He described the domestic economy as *“suffering from extraordinarily deep structural problems and a dramatically declining population”* and estimated that *“it will be an economy that suffers due to lack of domestic demand; they’ll never grow at 5% again, but more likely at 2%.”*
  - **India and Africa seem unable to replicate China’s miracle growth.** Following US Secretary of State Anthony Blinken’s visit to Ethiopia and Niger in March to address security challenges, US Vice President Kamala Harris visited Ghana, Tanzania, and Zambia, promising financial support. Many see this as an attempt to rival China’s influence in Africa, where the Chinese have loaned billions and remain heavily invested. As the US-China rivalry causes production to be moved out of China, some expect India to replace it as the world’s factory. But Mr. Kirkegaard noted, *“So far, India has been unable to benefit from relocation from China. Companies have gone to Vietnam and other countries. You have to wonder, especially since India and large parts of Africa are heavily affected by climate change, will these economies be able to produce jobs?”* He added, *“These areas will see continued population growth, but demographics don’t equal productive capacity. There’s nothing to indicate that these regions can replicate the growth miracle of China, so we shouldn’t think of them as rising to our rescue.”*
  - **Europe becomes an important piece on the US-China chessboard.** *“I don’t feel optimistic about where this ends,”* said a member. *“The multilateralism we’ve been promoting for years and years is shifting to a new kind of nationalism: China and US on one hand, Russia on the other, and Europe on the battleground in between.”* But Mr. Kirkegaard thought that the US-China rivalry could ultimately be advantageous for Europe: *“Europe’s in a fortuitous position in that it’s arguably the most important chess piece on the board. If you’re China, for example, and in perpetual rivalry with the US, avoiding Europe sliding into the orbit of the US may be the most important diplomatic or geopolitical goal you have to achieve. Future US administrations’ actions against the EU might also be similarly tempered.”*

## About this document

The European Audit Committee Leadership Network is a group of audit committee chairs drawn from leading European companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

*ViewPoints* is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisors as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, management, and advisors who become systematically engaged in this dialogue, the more value will be created for all.

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# European Audit Committee Leadership Network

EACLN

VIEWPOINTS

## Appendix 1: Participants

The following members participated in all or part of the meeting:



**Carolyn Dittmeier**  
Chair of Statutory  
Auditors, Generali



**Dagmar Kollmann**  
Audit Committee Chair,  
Deutsche Telekom



**Pilar Lopez**  
Audit Committee Chair,  
Inditex



**Benoît Maes**  
Audit Committee Chair,  
Bouygues



**David Meline**  
Audit Committee Chair,  
ABB



**Marie-José Nadeau**  
Audit Committee Chair,  
ENGIE



**Karyn Ovelmen**  
Audit Committee Chair,  
ArcelorMittal



**Erhard Schipporeit**  
Audit Committee Chair,  
RWE



**Carla Smits-  
Nusteling**  
Audit Committee Chair,  
Nokia



**Maria van der  
Hoeven**  
Audit Committee Chair,  
TotalEnergies

EY was represented in all or part of the meeting by the following:



**Marie-Laure  
Delarue**  
Global Vice Chair,  
Assurance, EY



**Jean-Yves Jégourel**  
Country Managing  
Partner Germany, EY



## Appendix 2: Reflection questions for audit committees

- ? What is your economic outlook for the year ahead? Has your company taken any direct action (e.g., reducing or pausing hiring, changing investment strategies) in response to the current economic environment?
- ? How is this economic environment affecting your industry in particular? Where do you see the most significant challenges occurring?
- ? Where and how does the board engage and how close to the operating decisions does it get? In this environment, how involved should the board be in advising management?
- ? How are you evaluating management's preparedness to manage through high inflation and a potential economic downturn?
- ? Have your board and management discussed the US Inflation Reduction Act and Europe's Carbon Border Adjustment Mechanism? What concerns or considerations have you identified?
- ? To what extent does your audit committee include trade matters and potential trade conflicts within its risk framework?
- ? Where within management do you monitor and manage risks related to global trade?
- ? How do you assess your company's linkages with China, either through supply chain arrangements or investment?

### Appendix 3: Guest biographies

**Andrew Kenningham** is the Chief Europe Economist for Capital Economics. He has overall responsibility for running the European economics service and contributes more broadly to international economic analysis. Andrew joined Capital Economics in 2011 and has worked on the Global Economics service.

Before joining Capital Economics, he was Deputy Chief Economist in the British Foreign Office and worked for Merrill Lynch for eight years, covering Emerging Europe, Middle East, and Africa for their fixed income business. Andrew has lived and worked as an economist in both Bulgaria and India. He has degrees in Economics and Economic History from Manchester University and the London School of Economics.

**Jacob Funk Kirkegaard** has been nonresident senior fellow with the Peterson Institute for International Economics (PIIE) and resident senior fellow with the German Marshall Fund of the United States (GMF) in the GMF's Brussels office since September 2020. He has been associated with the PIIE since 2002 and was resident senior fellow from 2013. Jacob is currently also a consultant with 22V Research, a private financial advisory firm in New York.

Before joining the PIIE, he worked with the Danish Ministry of Defense, the United Nations in Iraq, and in the private financial sector. He is the author, coauthor, or coeditor of *Transatlantic Economic Challenges in an Era of Growing Multipolarity* (2012), *US Pension Reform: Lessons from Other Countries* (2009), *The Accelerating Decline in America's High-Skilled Workforce: Implications for Immigration Policy* (2007) and *Transforming the European Economy* (2004).

He is a graduate of the Danish Army's Special School of Intelligence and Linguistics with the rank of first lieutenant, the University of Aarhus in Aarhus, Denmark, and Columbia University in New York and received his PhD from Johns Hopkins University, School of Advanced International Studies.

Jacob frequently appears in global media and his current research focuses on European economies and reform, Chinese long-term economic growth prospects, efficient decarbonization strategies, immigration, foreign direct investment trends and estimations, pension systems, demographics, offshoring, and the productivity impact of information technology.



## Endnotes

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<sup>1</sup> Eshe Nelson, “The European Central Bank Raises Rates Half a Point Amid Uncertainty,” *New York Times*, March 16, 2023.

<sup>2</sup> *ViewPoints* reflects the network’s use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.

<sup>3</sup> Emmanuelle Chaze, “German Chancellor Scholz Asks China for Economic Ties ‘as Equals,’” *France 24*, November 4, 2022.